

IN THE SUPREME COURT OF OHIO

Board of Education of the
Columbus City Schools)

Case No. 2007-1086

Appellee,)

vs.)

Franklin County Board of Revision,)
Franklin County Auditor, and)
Max E. Cougill,)

Appeal from the Ohio
Board of Tax Appeals

Appellees.)

BTA Case No. 2005-R-329
BTA Case No. 2005-R-330

and)

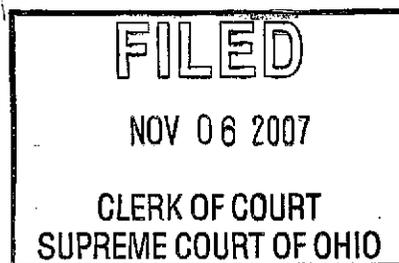
Board of Education of the
South-Western City Schools,)

Appellant,)

vs.)

Franklin County Board of Revision,)
Franklin County Auditor, and)
Max E. Cougill,)

Appellees.)



APPELLANT MAX E. COUGILL REPLY BRIEF

Nicholas M.J. Ray (0068664)
Jay P. Siegel (0067701)
Siegel Siegel Johnson & Jennings Co. LPA
3001 Bethel Road, Suite 208
Columbus, OH 43220
(614) 442-8885

Mark H. Gillis (0066908)
Rich Crites & Dittmer, LLC
300 East Broad Street
Suite 300
Columbus, OH 43215
(614) 228-5822

Counsel for Appellant
Max E. Cougill

Counsel for Appellees
Board of Education of the Columbus
City Schools and Board of Education
of the South-Western City Schools

William J. Stehle (0077613)
Assistant Prosecuting Attorney
373 South High Street
Columbus, OH 43215
(614) 462-3520

Counsel for Appellees
Franklin County Board of Revision
and Franklin County Auditor

Marc Dann (031514)
Ohio Attorney General
30 E. Broad Street, 17th Floor
Columbus, OH 43215-3428
(614) 466-4320

Counsel for Appellee
Richard A. Levin, Tax
Commissioner of Ohio

INTRODUCTION

The taxation of real property in Ohio was founded in and has stressed that “[l]and and improvements thereon shall be taxed by uniform rule according to value.” Ohio Const. Art. XII, § 2. Recently, the principle of uniform taxation without regard to who owns or occupies the building was reaffirmed by this Court in *Higbee Co. v. Cuyahoga Cty. Bd. of Revision* (2006), 107 Ohio St. 3d 325, wherein the Ohio Supreme Court rejected evidence of value inextricably intertwined with the non-real estate business value of the tenant. In essence what the Appellees ask of this Court is to turn a blind eye to information and conditions surrounding a sale of real property and blindly accept a sales price as the value of the property regardless of whether it results in uniform taxation and represents, in significant part, the business success of the tenant subject to a long-term lease rather than the value of the underlying real estate. By urging a blind, unthinking application of this Court’s decision in *Berea City School Dist. Bd. of Edn. v. Cuyahoga Cty. Bd. of Revision* (2005), 106 Ohio St.3d 269, the Appellees also fail to consider the specific statements and actions in this Court’s later decisions in *Strongsville Bd. of Edn. v. Cuyahoga Cty. Bd. of Revision* (2007), 112 Ohio St. 3d 309 and *St. Bernard Self-Storage, L.L.C. v. Hamilton Cty. Bd. of Revision* (October 10, 2007), ___ Ohio St. 3d ___, 2007-Ohio-5249 discussed *infra*.

The subject property was designed and built-to-suit specifically for use by Walgreens. Walgreens outsourced the development of the property. Rather than utilizing mortgage loan financing to pay off the costs of constructing the store, Walgreens instead entered into a long term lease with the developer to amortize the construction costs in lieu of a mortgage. The lease did not reflect the market value of the improvements, as many of the design requirements of the store were unique to the needs of Walgreens. Mr. Robert Murphy, an employee of Walgreens,

testifying on behalf of the company, testified to these facts before the Ohio Board of Tax Appeals, and such testimony was accepted into evidence by the Board. (Appellant's Supplement, pp. 4-15; Tr., pp. 13-55). Mr. Murphy is a representative of the company and obtains, keeps and utilizes such information in the course of his work for the company. He also testified that he is personally knowledgeable regarding the development plans for the tenant, Walgreens. (Appellant's Supplement, p. 7; Tr., p. 23). The Appellant has established these facts and they have not been contested by the Appellees. The Appellee's objections were noted by the Board of Tax Appeals and overruled. There is no basis established in the Appellee's Brief which would indicate that such a ruling by the finder of fact in this case should be overturned by this Court.

In fact, what this case presents is the exact situation set forth by this Court in *Higbee* where the business of the tenant conducted on the property should **NOT** result in a higher assessment than another similar property occupied by a less successful retailer. The subject property, occupied by Walgreens is at the intersection of Demorest and Clime Roads in Columbus. At that very same intersection on another corner is a CVS drugstore. Both drugstores have been the subject of recent sales. To apply the blind application of a sale price argued for by the Appellees would result in essentially similar real estate being assessed at 30% more than a CVS drugstore **at the same intersection**. There is no way that such a valuation results in uniformity as the sales represent the differing business success of the tenants—not the real estate itself. *The Appellees fail in any way to address how this would not result in a lack of uniformity and fail to repute any of the market evidence presented.* For a further discussion see Sales Comparison 1 on page 19 of Appellant's Brief.

The market evidence presented by the Appellant's appraiser, Mr. Lorms, concerning these properties and transactions at the same corner have in no way been contradicted by the Appellees. As will be discussed below, this type of testimony and introduction of evidence by a qualified expert witness is exactly what is contemplated under the rules of evidence. The Appellees frequently site to the fact that Mr. Cougill did not testify in this case. Mr. Cougill, lives out of state and has been discussed repeatedly in the testimony and in Mr. Lorms' appraisal report, the owner's of these triple net leased properties have no obligation for the maintenance or payment of any expenses, including real estate taxes, for the subject property. Appellant's acknowledge the burden to establish that the sale of this property does not reflect its true value for Ohio real estate tax purposes. The testimony of Mr. Cougill is not necessary in this case. The testimony of Mr. Lorms and the extensive review of this market and this transaction and many like it in his appraisal report establish that this sale is not reflective of the fee simple value of the subject property. The Appellant's have met this burden and then provided competent evidence as to the value of the fee simple estate of the subject property. Other than the sale information, a value which the Appellant has repudiated, the Appellees have provided no evidence of value.

The Appellant requests that this Court refuse to sanction the blind acceptance of a sale price that the market evidence and tenant and expert testimony proves is intertwined with the business success of the tenant and find that the value of the real property as of January 1, 2003 is \$1,300,000.

LAW AND ARGUMENT

Appellees' First Proposition of Law:

The Property Owner has the burden to prove that the sale price of real property does not reflect its true value in Money.

Appellant's Response:

The Property Owner has met its burden to establish that the sale price is reflective of the sale of a single tenant property valued in-use, where the property was built to that tenant's unique needs and the transfer is reflective of the business success and credit-worthiness of the tenant and is unrelated to the value of the underlying real estate.

In *Cincinnati Bd. of Edn. v. Hamilton Cty. Bd. of Revision* (1997), 78 Ohio St. 3d 26, the Court set forth a two step approach to overcoming a sale price as indicative of value. First, it must be shown that the sale price did not reflect true value. Through market evidence and tenant and expert testimony, the Appellants' have met this burden. Second, the value requested must be established. The Appellant, too, has met this requirement. As the Appellant demonstrated in the Merit Brief, Appellant's expert appraiser presented creditable, supported evidence that fully analyzed both the market and the actual transaction before the Board and arrived at a supportable value as to the value of the real estate. See Propositions of Law V and VII of Appellant's Brief.

The expert's role is to summarize and analyze the facts. Mr. Lorms provided a foundation for his opinions and analysis. The uniqueness of the property is demonstrated in his report based upon market knowledge and inspection of the property. Based upon the testimony of Mr. Lorms and after reviewing the lease rates and market lease information, the Board of Revision concluded that this sale was **not** reflective of the true value of the property. Unlike the BTA, the Board of Revision actually engaged in an analysis of the transaction and found that it was not reflective of the true value of the property. The BTA's assertion and then the Appellees support of same in their Brief before this Court that the market factors surrounding a transaction can only be established by a principal to the transaction cannot be maintained.

The testimony of expert witnesses to provide such information is clearly contemplated and allowed by the Rules of Evidence. Preliminarily, Rule of Evidence 602 provides that

A witness may not testify to a matter unless evidence is introduced sufficient to support a finding that he has personal knowledge of the matter. Evidence to prove personal knowledge may, but need not, consist of the testimony of the witness himself. **This rule is subject to the provisions of Rule 703, relating to opinion testimony by expert witnesses.** (Evid. R. 602, emphasis added).

The reference in Rule 602 to Rule 703 is designed to avoid any question of conflict between the two rules, the latter of which permits an expert to express opinions based on facts of which the expert does not have personal knowledge. Specifically, Rule 703 provides that:

The facts or data in the particular case upon which an expert bases an opinion or inference may be those perceived by or made known to the expert at or before the hearing. **If of a type reasonably relied upon by experts in the particular field in forming opinions or inferences upon the subject, the facts or data need not be admissible in evidence in order for the opinion or inference to be admitted.** (Evid. R. 703, emphasis added).

There is no question that the report and testimony of an appraiser is admissible as it relates to the transaction in question. First, the information relied on by Mr. Lorms was clearly made known to all parties and Mr. Lorms prior to the trial and it was both a part of Mr. Lorms testimony and his appraisal report. Secondly, it is beyond question that information regarding the facts and circumstances surrounding a sale is of the “type reasonably relied upon by [appraisers] in forming opinions or inferences.”

This conclusion is further supported by the Notes to Rule 703. The Notes discuss the various sources of information which experts can rely in providing testimony. The type of information at issue in this case is covered under the third set of reliable information. These Notes date back to the 1972 and provide:

The third source contemplated by the rule consists of presentation of data to the expert outside of court and other than by his own perception. In this respect the rule is designed to broaden the basis for expert opinions beyond that current in many jurisdictions and to bring the judicial practice into line with the practice of the

experts themselves when not in court. (1972 Notes to Evid. R. 703).

In *Worthington City Schools v. ABCO Insulation* (1992), 84 Ohio App.3d 144, 152, the court stated:

Some hearsay evidence necessarily is always involved with expert testimony. To become an expert, one must read and learn from sources which are necessarily outside the evidence at trial. It is this knowledge obtained from outside sources which qualifies a witness as an expert. (Citation omitted.) However, the facts or data which an expert relies upon in testifying must be either perceived by the expert or based upon evidence admitted at trial. Evid. R. 703.

The requirement of “perceived by the expert” refers to personal knowledge. Such perception and knowledge is recognized as being present in the case of an appraiser. *State v. Solomon* (1991), 59 Ohio St.3d 124, syllabus, held that “[w]here an expert bases his opinion, in whole or major part, on facts or data perceived by him, the requirement of Evid. R. 703 has been satisfied.” In *Worthington City Schools v. ABCO Insulation* at 153, the court, in finding that the trial court did not abuse its discretion in admitting an expert’s testimony, stated:

Here, the expert prepared the report personally, since he was the author. He had personal knowledge of the predicate for the contents of the article, so the facts were ‘perceived by him’ as required by Evid. R. 703.

Indeed, what is the job of an appraiser if it is not to determine whether a sale is arm’s length, if it is indicative of value, or it reflects the use-value of the property? Appraisers by necessity speak with brokers, owners, and property managers to find out details about a sale or a lease. Based on their experience and education, they make judgments about such issues. These are the decisions appraisers make as a necessary part of including data in their appraisals. Some data passes their professional tests such that it can be relied upon and included in their appraisals, and some data fails to meet the proper standard. If the actual property owner in this case came to

the BTA and declared that the sale is not reliable, or is a reflection of the value of the property in-use, the Appellees would have undoubtedly objected on the grounds that the owner does not possess the requisite knowledge or education to make such characterizations. This is not a situation where the expert was asked to testify in lieu of the buyer or the seller, but, rather, one that required the opinion of an expert to characterize the reliability of the transfer. In fact, Mr. Murphy of Walgreens did testify as to certain facts and circumstances surrounding the property. The use-value issue, in particular, is a characterization that an appraiser seems uniquely qualified to support, pursuant to their education about such matters.

The testimony of Mr. Lorms provides competent evidence as to the facts and circumstances surrounding the transfer of the subject property, as well as the characterization of its reliability. Such testimony is clearly the intent of Rule of Evidence 703. It is without question that expert opinion of Mr. Lorms in this case relates to facts that are of the type reasonably relied upon by appraisers in forming opinions or inferences.

The Appellant has met its burden to establish that the sale price is reflective of the sale of a single tenant property valued in-use, where the property was built to that tenant's unique needs and the transfer is reflective of the business success and credit-worthiness of the tenant and is unrelated to the value of the underlying real estate. The Appellant has also established the fee simple, value in exchange of the subject property. The Appellees contention in this regard are not well taken.

Appellees' Second General Proposition of Law: (in many parts)

Appraisals of real property based upon factors other than the sale price are appropriate for use in determining value only when no arm's length sale has taken place, or where it is shown that the sales price is not reflective of the true value.

Appellant's Response:

As discussed above, the Appellant has met its burden to establish that the sale price is not reflective of true value and, having met such burden, has introduced appraisal evidence to establish the true value of the subject property.

As discussed in detail above, the appraisal evidence presented by Mr. Lorms and the testimony of Mr. Murphy as to the development of the subject property, calculation of the rent and unique characteristics for Walgreens, establish that the sale is not reflective of the true value of the property.

At this point it is important to clarify, a mischaracterization of Mr. Lorms testimony that the Appellees repeated make in their brief. Beginning on page 4 and repeated throughout the brief, Appellees contend that Mr. Lorms testified that the only issue surrounding the lease of the property is that the lease rate was not a market rate and quote an exchange between Mr. Lorms and Appellees' counsel which is taken out of context.

The recross-examination where the quote taken by Appellees follows a re-direct examination by Appellant's counsel concerning sales included in Mr. Lorms report that were listed as "leased fee" sales and whether those sales can be used for establishing the fee simple value of the subject property. (see Appellant's Supplement, pp. 47-48, Tr. 183-186). In discussing whether a sale subject to a lease can be used for establishing the fee simple value, Mr. Lorms commented on the comparables that the rental amounts being paid were fair rental rates. (see Appellant's Supplement, pp. 47-48, Tr. 185-186). Mr. Lorms were clear that these properties were *not* build to suit properties. *Id.* Appellee's counsel then follows up with this line of questioning and Mr. Lorms' responses have to do with the use of leased fee sales in a fee simple appraisal.

It is clear from Mr. Lorms testimony and report that leases resulting from build to suit arrangements do not meet the definition of market rent. On page 3 of Mr. Lorms report

(Appellant's Supplement, p. 58), in indicating why the sale was not utilized in his report, among many other reasons, Mr. Lorms states that

the property was never available on the open market. . . . The tenant selects the site and gives the developer all of the design and construction specifications. Walgreens has a specific rent-to-cost factor that determines the rent paid. Therefore, the rent is predetermined, based on an amortization of the construction costs, and doesn't take obsolescence or what the property would lease for on the open market into consideration. It merely reflects what the user the property was designed for would pay for the space, which provides an indication of the use value (value in use), not market value or value in exchange. In addition, the tenant's credit worthiness and the length of the lease term are significantly above average, resulting in a capitalization rate that is significantly below what is applicable to a retail property on a fee simple basis.

Mr. Lorms again discusses the requirements for market rent and the differences between fee simple and leased fee valuations at the beginning of his valuation section. (Appellant's Supplement, p. 104, Lorms, p. 49). This is followed by an in-depth discussion of the implication of build-to-suit properties and the determination of a fee simple value since the original lease is not the result of market activity and does not meet the definition of market rent. (Appellant's Supplement, pp. 105-115, Lorms, pp. 50-60). None of this market evidence, which goes directly to the reliability of this sale to establish the value of the real estate free from the business needs and creditworthiness of the tenant has been refuted by the Appellees. In fact, they once again fail to address it.

Mr. Lorms, not based upon some rogue theory as the Appellees would have this Court believe, but based upon analysis of numerous market transactions and analysis—the role of an expert—has shown that the transfer in this case is not solely a reflection of the value of the real estate. These market indications are also discussed at length in Appellant's Brief. Appellees' arguments that Mr. Lorms opinions are unsupported or only based upon the solely the lease rate is simply not supported by the record in this case.

The remainder of Appellees arguments in this area spring from this incorrect attempt to argue that Mr. Lorms position is solely based upon the lease rate of the build-to-suit lease. As has been shown above and can be seen by actually reading the exhaustive discussion in Mr. Lorms' report this is simply not the case.

Furthermore, in reviewing the sub-arguments presented by Appellees, first, Appellant's have never argued that the fact any property is subject to a lease would disqualify it from reflecting the true value of the property. This is simply an attempt to extrapolate the narrow argument advanced by the Appellant to an illogical extreme in an attempt to inflame the Court. The situation presented to the Court in this case is very narrow and limited to those very small number of occasions related to single-tenant, build to suit properties where the leases never met the definition of a market rent (similar to sale-leaseback transactions) and the transfer is shown to be impacted by the business success of the tenant and not solely a reflection of the value of the real estate. Appellees attempt to scare this Court by trying to make this case about more than the very limited type of transaction before it. It is also ridiculous to claim that the terms "build to suit" and "value in use" were invented by the appraiser. (Appellees' Brief, p. 13). The articles included in the appraisal, beginning on page 181 of Appellant's Supplement, discuss build-to-suit at length and as discussed in more detail below, value in use comes directly from *The Appraisal of Real Estate* published by the Appraisal Institute. Appellees' counsel only harms his own credibility when such statements are made.

As discussed above, Appellees essentially argue for a blind application of this Court's decision in *Berea*. (see, Appellees' Brief, p. 14). In fact this Court has never endorsed a blind acceptance of a recorded sale price when evidence indicates that it is not reflective of the true value of the real property. This was most recently endorsed by this Court in *St. Bernard Self-*

Storage, L.L.C. v. Hamilton Cty. Bd. of Revision (October 10, 2007), ___ Ohio St. 3d ____, 2007-Ohio-5249. In *St. Bernard*, the purchaser argued that a sale price negotiated by the buyer and seller for the real estate and reflected on the face of the sale agreement and on the conveyance fee statement should “automatically acquire the force of presumptive—if not conclusive—validity.” *St. Bernard*, ¶ 16. This Court’s response—“We disagree.” *Id.* In not endorsing such a blind acceptance of the price stated for the real estate this Court commented that while such an approach would be simple to apply, it is not appropriate. *Id.* The same situation applies in the present case. Appellant agrees that just accepting the sale price would be simple—it is just not appropriate.

This Court also recently commented in *Strongsville Bd. of Edn. v. Cuyahoga Cty. Bd. of Revision* (2007), 112 Ohio St. 3d 309, that this Court’s *Berea City School Dist. Bd. of Edn. v. Cuyahoga Cty. Bd. of Revision* (2005), 106 Ohio St.3d 269 decision contemplates an analysis of the transaction and not blind acceptance of a sale price. The BTA, unfortunately, in this case just blindly accepted the sale price and failed to consider the evidence indicating that the sale price did not reflect the true value of the real estate. The blind acceptance of a sale price is obviously not this Court’s mandate in *Berea* as its later decisions have indicated.

Such an analysis in this case, supported by market evidence and expert testimony, proves that the sale price does not reflect only the value of the real property and the decision of the Ohio Board of Tax Appeals blindly accepting such a value without deeper analysis of the fundamentals surrounding the transaction must be over turned.

The second sub argument set forth by the Appellees in this area is that simply a distinction between market rent and actual rent cannot be used to discredit a sale. As discussed above and in detail in Mr. Lorms report as cited above, Appellees conveniently ignore the

significant breath of Appellant's argument as the to factors that disqualify the sale in this case and attempt to focus on only one point. A review of the extensive evidence in this case and Appellant's Merit Brief will better serve to inform the Court as the various reason why the transfer in this case is not reflective of the market value of the real estate.

Appellees' Third Proposition of Law:

A value in use or use value is a value that is based on a use other than the highest and best use of the property.

Appellant's Response:

Value in use is a valuation concept set forth in *The Appraisal of Real Estate*, 12th Edition, published by The Appraisal Institute. Highest and best use concerns the use of the property and not is value. Appellees confuse these terms.

The valuation of a property to the user it was designed for as compared with the market value for the property is addressed by *The Appraisal of Real Estate*, 12th Edition, and is distinguished from the fair market value of the property in exchange. It is clear from the appraisal treatise that the use value could be lower or higher than the fair market value.

Specifically, in addressing the use value of a property, *The Appraisal of Real Estate*, 12th Edition, pp 24-25, (emphasis added) states:

The realities of current real estate practice frequently require appraisers to consider *other types of value in addition to market value*. One of these, use value, is a concept based upon the productivity of an economic good. *Use value is the value of a specific property has for a specific use*. In estimating use value, the appraiser focuses on the value of the real estate contributes to the enterprise of which it is a part, *without regard to the highest and best use of the property* or the monetary amount that might be realized from its sale. Use value may vary depending upon the management of the property and external conditions such as changes in business operations. For example, a manufacturing plant designed around a particular assembly process may have one use value before a major change in assembly technology and another use value afterward.

Real property may have a use value and a market value. An older factory that is still used by the original firm may have considerable use value to that firm but only a nominal value for another use.

These are some of the exact same issues to be addressed in the instant case. It is important to consider this transaction not in a vacuum, but in the context of the market as a whole. To believe that it is probable that the sale of the subject property, as a function of its value-in-use lease, further driven by the business success and creditworthiness of Walgreens as lessee, is equal to the value of the underlying real estate, one would have to ignore the market realities set forth in Mr. Lorms report and summarized in Appellant's Merit Brief in its second proposition of law. Summarized, the Appellees position would have this Court reject use value if it results in a lower value but finds no problem with it if it results in increased taxation.

Furthermore, the Appellees confuse use value, a valuation construct, with highest and best use, a use construct. As quoted above, *The Appraisal of Real Estate*, 12th Edition, makes the distinction that "[i]n estimating use value, the appraiser focuses on the value of the real estate contributes to the enterprise of which it is a part, *without regard to the highest and best use of the property.*" *The Appraisal of Real Estate*, 12th Edition, p. 24. If highest and best use and use value were the same thing, there would be no need for such a distinction. The value in use is focused on the current user of the property; not the market use for the property. These are two different things.

Appellees' Fourth Proposition of Law:

A claim that a sale price is based on the credit worthiness of a tenant is not sufficient to preclude the use of the sale price to value the property for tax purposes under R.C. 5713.03.

Appellant's Response:

This Court's holding in *Higbee Co. v. Cuyahoga Cty. Bd. of Revision* (2006), 107 Ohio St. 3d 325, clearly rejected evidence of value inextricably intertwined with the non-real

estate business value of the tenant. Appellant's have demonstrated that the sale transaction in this case is inextricably intertwined with the non-real estate business value of the tenant.

In *Higbee*, the Property Owner proffered evidence in which the valuation of a single-tenant retail property was based upon the gross sales of a tenant. This Court rejected this approach as an impermissible valuation of the property essentially in use. In rejecting a valuation based on gross sales, this Court held:

If it is the real property being valued, its valuation cannot be made to vary depending on the success or lack thereof of the businesses located on the property. Admittedly, the location of a property may influence the sales made by a merchant at that property. However, the merchant's business practices may also influence sales. The business factors and the real-property factors must be separated when the real property is being valued for tax purposes. *Higbee, supra*, at 395.

This Court acknowledged that gross sales could vary by location, but the influence of the business practices would remain with the tenant. That is, while gross sales could be partially attributable to the location of the real estate, they could also be attributable to the success or lack thereof of the tenant as a business, and therefore this Court rejected valuation based on gross sales. Similarly, in this case, the business practices of the tenant, Walgreens, have resulted in significantly above average credit-worthiness, which in turn drives the resulting sale price higher than it would otherwise be. Whether it is gross sales or credit-worthiness, both are a function of the tenant. In fact, credit-worthiness has an even stronger correlation with the tenant's business practices than gross sales does. Indeed, gross sales for the same tenant, say Walgreens, can vary by location, but their credit-worthiness remains constant no matter which location they are operating from. (See the discussion and market examples in Mr. Lorms' report on pages 58 through 60. Appellant's Supplement, pp. 113-115.) As such, there would tend to be an even greater non-real estate component that is a function of credit-worthiness when compared to gross

sales. If gross sales impermissibly clouded the value in *Higbee*, the successful business practices of Walgreens and its above-average credit-worthiness, which artificially inflated the sale price, should be of even greater concern to this Court.

The fact that the sale price in this case was driven by the success and credit-worthiness of Walgreens has not been disputed just as the other market evidence has not been disputed by the Appellees. The Appellees again attempt to segregate and set forth Appellant's arguments as mutually exclusive such that, in Appellees' argument, any one of them standing on their own must fail. That is clearly not the case being presented to this Court. While anyone factor, by itself, may not be sufficient, Appellant has provided numerous factors supported by undisputed evidence to support the ultimate conclusion that the sale transaction before this Court does not reflect simply the value of the real estate and therefore is not indicative of the true value of the property for Ohio real estate tax purposes.

Appellees' Fifth Proposition of Law:

An arm's length sale between unrelated parties with no prior dealings is not a sale/leaseback transaction.

Appellant's Response:

Appellant's argument is not that this transaction is a sale-leaseback transaction but that the same concerns that would caution against blind acceptance of a sale-leaseback transaction are also present in the transaction before the Court in this case.

The Court has consistently rejected as evidence of value a sale that involves a sale/leaseback transaction. See *Strongsville Bd. of Edn. v. Cuyahoga Cty. Bd. of Revision* (2007), 112 Ohio St. 3d 309; *S. Euclid/Lyndhurst Bd. of Edn. v. Cuyahoga Cty. Bd. of Revision* (1996), 74 Ohio St. 3d 314, 317; *Kroger Co. v. Hamilton Cty. Bd. of Revision* (1993), 67 Ohio St. 3d 145; *Cleveland Hts./Univ. Hts. Bd. of Edn. v. Cuyahoga Cty. Bd. of Revision* (1995), 72 Ohio St. 3d 189; *Pingue v. Franklin Cty. Bd. of Revision* (1999), 87 Ohio St. 3d 62. In these

cases, this Court concluded that such sales are nothing more than financing transactions for the underlying real estate. In the typical sale/leaseback transaction, the user builds the building, sells it, and leases it back. This type of transaction is virtually identical in both structure and purpose to the build-to-suit, net lease sale that is the basis of the Appellees' opinion of value in the instant matter. In both types of transactions, the leases are designed to amortize the costs of development, while allowing the user greater financial flexibility. As Mr. Lorms testified:

Whether the user designs, builds, and owns their own facility; designs, builds, and enters into a sale/leaseback transaction; or enters into a build to suit lease agreement with a developer, the development costs, sale price, or lease rates are driven by the value in use to the business enterprise. (Appellant's Supplement, p. 107; Lorms, p. 52).

Mr. Lorms elaborates further on this point:

Where a building is designed and constructed to meet the user's specific needs, regardless of whether the ultimate transaction results in the user leasing the new building, purchasing it from the developer, or building it itself and then selling to an investor (sale/leaseback), the final outcome is identical – a financial transaction to accommodate the value-in-use by the specific user. The value reflected by that transaction is unique to that specific user and not, in and of itself, reflective of the market value or value in exchange of the property." (Appellant's Supplement, pp. 24 and 108; Tr., p. 90; Lorms, p. 53).

As discussed in detail in Mr. Lorms' report, the entire process of building the subject property and entering into the lease is a closed transaction not open to the market. (Appellant's Supplement, p. 58; Lorms, p. 3). Indeed, the Appraisal of Real Estate and this Court have repeatedly emphasized the importance of exposure to the open market before properly relying on a transaction. (See, *Kroger, supra*).¹ This fact alone should render the instant sale suspect. As

¹ According to the Appraisal of Real Estate, 12th Ed., p. 83, market rent is "[t]he rental income that a property would probably command in the *open market*." (Emphasis added). In its definition of market value, the Appraisal of Real Estate, 12th Ed. p. 22, indicates that it is "[t]he most probable price . . . for which the specified property rights should sell *after reasonable exposure in a competitive market*." (Emphasis added).

discussed above, based upon subsequent decisions it should be clear that this Court did not and does not endorse a blind acceptance of a sale price. The sale-leaseback cases which present similar factual situations to those in the present case only further support this contention. The BTA failed to properly consider all the evidence before it in this case. The testimony of Messrs. Lorms and Murphy establishes that the sale should not be relied upon. It was not necessary that Mr. Cougill or a principal to the transaction testify as it was within the realm of expert testimony. The BTA's blind reliance upon the sale price in light of this Court's sale-leaseback jurisprudence and the cases decided after *Berea* amplifying this point simply cannot stand.

In *Strongsville*, this Court found that *Berea* did not end any and all inquiries into the reliability of a given sale. When the BTA received evidence sufficient to rebut the presumption that the *Strongsville* sale was not arm's length, this Court found the BTA correctly rejected the sale as the best evidence of value. However, in the instant matter, the BTA erroneously failed to make an equally important determination – whether the lease that encumbered the property at the time of the sale, which formed the basis for the purchase price, was itself an arm's length transaction.

As the original lease was not an arm's length transaction, it follows that any subsequent sale based upon that lease would render it unreliable. As Mr. Lorms states in his report,

The lease rate was negotiated prior to construction between Walgreens and the developer and the property was never available on the open market. In these build to suit arrangements, the developer acts as an outsourcing of the financing and construction for the retailer. The tenant selects the site and gives the developer all of the design and construction specifications. Walgreens has a specific rent-to-cost factor that determines the rent to be paid. Therefore, the rent is pre-determined, based on an amortization of the construction costs, and doesn't take what the property would lease for on the open market into consideration. (Appellant's Supplement, p. 86; Lorms, p. 3).

The lease is never negotiated on the open market. . . . In summary, the developer essentially acts as a financing and construction arm of the user/tenant and the characteristics of the arrangement do not meet the definition of an arm's length transaction." (Appellant's Supplement, p. 82; Lorms, p. 27).

It must be emphasized that the Appellant's contention that the original lease does not meet the characteristics of an arm's length lease was never challenged by the Appellees or the BTA. In addition, there is no dispute that the purchase price for the property was driven by the lease. Consequently, any sale based upon a lease that is not arm's length must itself be rejected as an unreliable indication of value.

Because sale/leaseback transactions have been repeatedly rejected by this Court as indicators of value, and since value-in-use, net lease transactions have the same inherent unreliability in reflecting the unencumbered, fee simple value of the property, this Court should also reject value-in-use net lease sales which are similar in character to sale/leaseback transactions.

CONCLUSION

The sale of the subject property is not indicative of the market value of the real estate, but the value-in-use of the subject to a highly successful tenant. This conclusion is supported by the record in this case, appraisal theory, and overwhelming confirmation from sales that occurred in the market under similar circumstances. Contrary to the assertion by the BTA and Appellees, the Appellant has not and does not argue that *all* build-to-suit transactions can *never* be considered qualifying sales; that *all* sales of successful retail locations should be disregarded; or, that a sale of a property encumbered with a long-term lease entered into by a developer and a user can *never* be considered an indication of fair market value. In a fluid market, it is not possible to extrapolate one transaction to an entire market and the Appellant does not argue that here. The

evidence in this case, both in terms of the subject property and supporting market examples, demonstrates that the specific transaction before the Board does not reflect the value of the underlying real property.

If there were any correlation between value-in-use, net lease sale prices and the value of the underlying real estate, the subject Walgreens would not sell for 30% more than a CVS at the same intersection. Market evidence would be available to support such a proposition. There is none in this case because none exists. The market transaction set forth by Mr. Lorms demonstrate that the sale prices of properties such as the subject are entirely unrelated to the value of the underlying real estate.

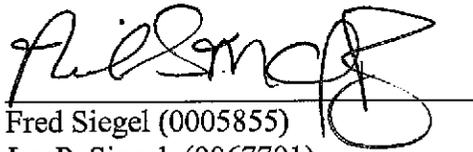
Further proof of this can be found in the fact that the sale of the subject was well in excess of its replacement cost, contradicting the well-established principle of substitution that no buyer would pay more for a property than it would cost to build a similar property. In this case, the purchase price was approximately 44% higher than the cost to replace the property **with a new building**. No buyer would do that unless the transfer price reflects the value of the Walgreens lease.

The sale is also functionally equivalent to other types of evidence of value rejected by this Court, including evidence of valuations intertwined with the success of the tenant as a business as seen in *Higbee*. In the instant case, the sale price is undeniably linked to the successful business practices of Walgreens and its above-average credit-worthiness. Therefore, acceptance of the sale price in the instant matter would be contrary to this Court's mandate in *Higbee*. Finally, the *Berea* case is not relevant to the instant matter as the *Berea* sale did not reflect the value of that property in use or the success and credit-worthiness of the tenants.

The Property Owner has further offered competent, probative appraisal evidence in support of an unencumbered, fee simple value of the subject property.

For all of the foregoing reasons, the Appellant respectfully submits that the decision of the BTA is unreasonable and unlawful. Accordingly, the Appellant respectfully requests that this Court reverse that decision and find that the value of the subject property as of the tax lien date was \$1,300,000. Alternatively, due to the failure of the BTA to properly consider the testimony of the expert witness, the Appellant would respectfully request that this matter be remanded to the BTA with instructions that the sale is not reflective of the value of the subject property and the BTA should analyze the reports and testimony of the expert to arrive at the value of the subject property.

Respectfully submitted,



Fred Siegel (0005855)

Jay P. Siegel (0067701)

Nicholas M.J. Ray (0068664) (Counsel of Record)

Siegel Siegel Johnson & Jennings Co

3001 Bethel Rd., Suite 208

Columbus, OH 43220

(614) 442-8885

Attorneys for Appellant

CERTIFICATE OF SERVICE

This is to certify that on this 6th day of November 2007, a copy of the Appellant Max E. Cougill Reply Brief was sent via regular U.S. mail to Mark H. Gillis, Rich Crites & Dittmer, LLC 300 East Broad Street, Suite 300, Columbus, OH 43215, William Stehle, Franklin County Assistant Prosecuting Attorney, 373 South High Street, 20th Floor, Columbus, OH 43215, and Lawrence Pratt, Section Chief-Taxation, Marc Dann, Ohio Attorney General, 30 East Broad Street, 17th Floor, Columbus, OH 43215-3428.



Nicholas M.J. Ray, Esq.